

Choice of US Entity for Foreign Companies

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Foreign companies (“FC”) wishing to establish a U.S. entity to expand their business activities in the U.S. will need to consider whether to form a corporation (Inc.) or a limited liability company (LLC). Likewise, an FC which wants to invest in an Inc. or an LLC will need to be familiar with certain tax and non-tax aspects of an Inc. and an LLC. Professional services, such as architecture and engineering, may require a special professional services entity (which will not be addressed in this article).

An Inc. and an LLC are similar in that they both offer limited liability to their owners (shareholders of an Inc. or members of an LLC). In general (with some exceptions), an FC is not liable for the obligations of an Inc. or LLC.

Following are some of the main differences between both entities:

Taxation:

- An Inc. is subject to U.S. federal, state and local corporate income tax. An LLC is not subject to federal or state income tax (but may be subject to local tax, such as the New York City unincorporated business tax). Profits of an LLC are allocated or “passed-through” to its owners, who are subject to U.S. income tax on those profits, whether or not distributed, and who will need to file U.S. income tax returns for their share of the LLC’s profits.
- An FC which owns an LLC will need to obtain a U.S. federal taxpayer identification number and will need to appoint a person whom the IRS can contact for any tax matters of the LLC (so-called “partnership representative”). That person does not need to be a U.S. citizen or resident.
- Professional investors, such as venture capitalists, often do not want to invest in LLCs because of their flow-through tax treatment. In order to avoid pass-through tax treatment to the FC, an LLC can file an election with the IRS to be taxed as a corporation. Alternatively, the FC could establish a so-called “blocker” corporation which will own or invest in the LLC.
- Dividends from an Inc. to the FC are generally subject to a U.S. withholding tax or a reduced income tax treaty rate, if applicable. After-tax profits of an LLC are generally subject to a U.S. “branch profits” tax (or a reduced income tax treaty rate, if applicable) when distributed or deemed distributed to the FC. In contrast, net profits distributed to an owner in the U.S. are not taxed again.

Management:

- An Inc. is managed by directors and officers. The directors are responsible for overall management of the Inc. Although they make certain management decisions, such as approving a major contract, they generally do not sign contracts on behalf of the Inc. Directors are elected and removed by the shareholders. The officers are responsible for day-to-day management

and sign contracts and other documents on behalf of the Inc. The officers include a President/CEO, Secretary and a Treasurer. They are elected and removed by the directors. The directors and officers must be individuals. They do not need to be U.S. citizens or residents. All director and officer functions can be combined in one person.

- An LLC is managed by one or more managers or by the owners of the LLC. A manager can be either an individual or a corporate entity and does not need to be a U.S. citizen or resident.

Formation costs: Although the costs of formation of an Inc. and an LLC are comparable, an LLC which will register in New York will need to publish its formation in two newspapers in New York. Publication costs can make the formation or registration of an LLC in New York more expensive than that of an Inc.

Corporate Organizational Documents. Both an Inc. and an LLC are formed by filing a formation document with the secretary of state of the state in which the entity will be formed. An Inc. will also need to have several additional organizational documents, including a statement of "incorporator" for the election of the first director(s), a written consent of the first director(s) electing the first officer(s), bylaws, issuance of the first shares to the FC and a shareholders' agreement if more than one shareholder. An LLC will only need an operating agreement between the LLC and its owner(s) providing for, among other things, the management of the company and the allocation and distribution of profits and losses.

Sharing of Profits and Losses. Shareholders of an Inc. share in the profits in proportion to their ownership percentages. Owners of an LLC share in the profits and losses as agreed to between the owners in the operating agreement. If an FC invests in a joint venture company and wishes to allocate profits and losses to the joint venture partners in a ratio which is different from the ownership percentages, the FC should consider forming the JV entity as an LLC.

All in all, generally, unless there is a need for pass-through tax treatment, management by a corporate entity, or a flexible joint venture entity, an FC will probably prefer to establish or invest in an Inc. instead of an LLC.